



SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-73805; File No. SR-FICC-2014-11]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to Amend the Government Securities Division Rulebook and the Mortgage Backed Securities Clearing Rules In Order to Move the Time of Novation with Respect to Certain Trades, Include Rules to Reflect Existing Processes, and Clarify Certain Rules to Reflect Current Practices

December 10, 2014.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4,² notice is hereby given that on December 2, 2014, Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FICC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

FICC is proposing to (1) move the time of novation for netting eligible transactions submitted to the Government Securities Division (“GSD”) in accordance with the GSD Rulebook (“GSD Rules”) and for SBO-Destined Trades³ submitted to the Mortgage-Backed Securities Division (“MBSD”) in accordance with the MBSD Clearing Rules (“MBSD Rules”)

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The MBSD Rules define a “SBO-Destined Trade” as a to-be-announced (“TBA”) transaction in the clearing system intended for TBA Netting in accordance with the provisions of the Rules. MBSD Rule 1, Definitions. In a TBA transaction, members agree on a sale price, quantity, and the characteristics of the securities being sold, but they do not specify which particular securities will be delivered on the settlement date.

in order to provide members with additional legal certainty that FICC will be the legal counterparty with respect to their guaranteed trades for purposes of regulatory capital requirements, (2) include rules to reflect existing processes, and (3) clarify certain rules to reflect current practices.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FICC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FICC has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

A. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change.

1. Purpose

FICC is proposing to move the time of novation applicable to certain transactions submitted to the GSD and MBSD to earlier in the clearing process in order to provide members with additional legal certainty that FICC will be their legal counterparty with respect to their guaranteed trades for purposes of members' regulatory capital requirements.

Currently, GSD and MBSD guarantee the settlement of a trade upon comparison, which generally occurs when FICC issues initial "output" to GSD netting members or MBSD clearing members, as applicable, indicating that their trades have compared,⁴ provided that the trade

⁴ In the case of GSD locked-in trades, comparison occurs upon receipt of the trade data submitted to FICC from the locked-in trade source. GSD Rule 6C.

meets the requirements of the GSD Rules or the MBSD Rules, as applicable.⁵ This means that FICC is responsible for settling the guaranteed trades, even if one of the members who submitted the trade becomes insolvent.

Novation, which refers to the termination of delivery, receive and related payment obligations between the original parties to the contract and the replacement of such obligations with identical obligations between each party and FICC, currently does not occur until later in the clearing and settlement process than comparison. In GSD, novation currently occurs when subsequent “netting output” is issued to netting members (usually the day before settlement); in MBSD, novation currently occurs when subsequent “pool netting output” is issued to clearing members (usually the day before settlement).

Because there is a legal distinction between the concept of “guarantee” and “novation”, and this legal distinction may have a bearing on how members calculate their capital requirement, FICC proposes to move the time of novation (i.e. the point that FICC becomes the legal counterparty) so that it occurs at the time of the trade guarantee.

Time of Novation – Proposed Changes

FICC is proposing to revise the GSD Rules and MBSD Rules so that novation will occur at comparison for netting eligible transactions (for GSD) and SBO-Destined Trades (for MBSD). This means that, at the point of trade comparison, FICC will guarantee the settlement of the transactions (as it does today) and novate such transactions, becoming the legal counterparty to each submitting member with respect to such transactions.

⁵ See GSD Rule 11B and MBSD Rule 5.

Under the proposal, in the GSD, all netting eligible transactions that compare in accordance with the GSD Rules will novate at the point of comparison.

In the MBSD, only SBO-Destined Trades, all of which are included in the TBA Netting process and (pursuant to proposed Section 7 of Rule 8 which is being added to reflect a current requirement and current practice) must be submitted to the Pool Netting process,⁶ will novate at the point of comparison. Other types of transactions, including Trade-for-Trade Transactions⁷ and Specified Pool Trades,⁸ will continue to be guaranteed at comparison, as they are today, but FICC will not novate such transactions at comparison. Instead, such transactions will be treated as they are today: (1) to the extent Trade-for-Trade Transactions are included in the Pool Netting process,⁹ FICC will novate such Transactions once the Pool Netting¹⁰ process is completed and

⁶ The MBSD conducts two separate netting processes to consolidate settlement obligations and reduce the number of securities and the amount of cash that must be exchanged to settle transactions. TBA Netting is the process used to net SBO-Destined Trades that have compared in accordance to the MBSD Rules. TBA Netting is conducted before particular securities (“pools”) are identified to the SBO-Destined Trades. Pool Netting, which occurs after MBSD clearing members allocate pools to transactions, is the process used to aggregate and match offsetting pool delivery obligations submitted by MBSD clearing members to satisfy their settlement obligations. MBSD Rules 6 and 7. An MBSD clearing member may submit a transaction to Pool Netting even if such transaction was not submitted for TBA Netting.

⁷ The MBSD Rules define “Trade-for-Trade Transaction” as a TBA transaction submitted to FICC not intended for TBA Netting in accordance with the provisions of the Rules. MBSD Rule 1, Definitions.

⁸ The MBSD Rules define “Specified Pool Trades” as a trade in which all required pool data, including the pool number to be delivered on the contractual settlement date, are agreed upon by the clearing member at the time of execution. MBSD Rule 1, Definitions.

⁹ Trade-for-Trade Transactions that are not submitted to the Pool Netting process must be settled outside of FICC between the submitting counterparties.

¹⁰ As noted in SR-FICC-2008-01, a clearing member that has a trade that was matched with a stipulation (“Stip Trade”) would not submit such trade for Pool Netting. Pool

(2) Specified Pool Trades, which are not included in the TBA Netting process nor the Pool Netting process, are not novated today (they settle outside of FICC between the submitting counterparties) and will continue to not be novated under the proposal.¹¹

In order to effectuate this change in the time of novation as described above, the proposed rule change adds language to the GSD Rules (new Section 8 of Rule 5) and MBSD Rules (new Section 13 of Rule 5) that states that FICC will guarantee and now novate applicable transactions upon comparison, subject to the parameters set forth in the proposed rule change. Conforming changes are proposed to be made to GSD Rule 3A, GSD Rule 6B, GSD Rule 6C, GSD Rule 11, GSD Rule 14, GSD Rule 20, GSD Rule 21A, Rule 22B, MBSD Rule 6, MBSD Rule 8, MBSD Rule 10, MBSD Rule 11 and MBSD Rule 17A. In addition, the definition of “novation” in both Divisions’ Rule 1 is clarified to reflect that delivery, receive and related payment obligations between members will be terminated and replaced with identical obligations to and from FICC at the point in time that the trade is compared in accordance with the applicable Rules.

The proposed rule change also addresses the fact that in the MBSD today certain settlement obligations continue to be settled between the settlement counterparties and not vis-à-vis FICC; these are the obligations that were not included in the Pool Netting process pursuant to MBSD Rule 8 (Pool Netting). The present proposal does not change this existing process.

Netting creates delivery obligations based off the net position of clearing members without regard to the original counterparty relationship. With a Stip Trade, the buyer and seller will want to ensure the receipt or delivery, as applicable, is maintained between themselves to ensure that the other party adheres to the stipulated terms. Securities Exchange Act Release No. 34-66550 (March 9, 2012), 77 FR 15155 (March 14, 2014) (SR-FICC-2008-01). Therefore, as with the current process, FICC does not expect to novate Stip Trades.

¹¹ MBSD Rule 10.

However, because the present proposal introduces legal novation at comparison for certain MBSD transactions, the proposed rule changes (in Rule 5, Section 2) make clear that the settlement counterparties continue to settle with each other but do so on behalf of FICC for those transactions that are novated to FICC.

The proposal to move the time of novation as noted above does not change FICC's risk. Because FICC currently guarantees eligible trades upon comparison, FICC already assumes responsibility for settling such trades at the point of comparison. Adding legal novation at the point of comparison does not increase FICC's obligations and therefore, does not require any changes to FICC's risk management processes. In addition, FICC is not proposing to change its operational processes.

Proposed Formalization of Existing Processes

In addition, the proposed rule changes formalize the following existing processes:

- As noted above, Section 7 of MBSD Rule 8 is added to state that all SBOO Trades and SBON Trades (i.e., SBO-Destined Trades after such trades have gone through TBA Netting) must be submitted to Pool Netting.
- MBSD Rules 15 and 16 are revised to clarify that, upon the insolvency of a member's original counterparty to a compared trade, such member cannot unilaterally modify its obligations with respect to transactions originally entered with such counterparty. In the MBSD Rules, because certain trades are not novated and will continue to not be novated under this proposal, FICC proposes to make clear that upon a cease to act with respect to a member by FICC, the solvent member to a compared trade with the defaulting member may not unilaterally act with respect to such trade.

These changes are not intended to change FICC's current operations or processes.

Proposed Clarification to Reflect Current Processes

In addition, the proposed rule changes clarify certain Rules to reflect actual practices and requirements as follows:

- MBSD Rule 17 is revised to clarify that when FICC ceases to act for a member, FICC may dispose of such member's Trade-for-Trade Transactions based upon their generic terms.

These changes are not intended to change FICC's current operations or processes.

Specific Proposed Changes

With respect to the GSD Rules, the proposed changes are as follows:

- The term "Interactive Submission Method" is revised to correct a typographical error.
- For clean-up and clarification purposes, the term "Novation" is revised to reflect that delivery, receive and related payment obligations between GSD netting members will be terminated and replaced with identical obligations to and from FICC at the point in time that the trade is compared in accordance to the GSD Rules.
- Rule 3A, Sections 2(i), 7(a), 7(d), 14(c), and 16(a) are revised to reflect that trades submitted by Sponsored Members¹² will novate to FICC at the time that such trades receive FICC's guaranty of settlement.
- Rule 5 is revised to include a new Section 8 entitled "Novation and Guaranty of Compared Trades" which provides for the following: (1) compared trades that meet the requirements of the GSD Rules and were entered into in good faith will novate to FICC and FICC will guarantee the settlement for each such compared trade; (2) if a compared trade

¹² The term "Sponsored Member" means any Person that has been approved by the Corporation to be sponsored into membership by a Sponsoring member pursuant to Rule 3A. GSD Rule 1, Definitions.

becomes uncomparared or cancelled, FICC's guaranty and novation of such trade will be reversed and cancelled; (3) if a compared trade is modified after novation and such modification does not cause the trade to become uncomparared, then the modification will cause a corresponding modification to the deliver, receive and related payment obligations between the GSD netting members and FICC; (4) at the time that a compared trade becomes novated, such trade ceases to be bound by any bilateral agreement between the parties with respect to the deliver, receive and related payment obligations, however, if the trade becomes uncomparared or is cancelled, such trade shall be governed by the bilateral agreement that governed the trade prior to the novation; and (5) if a right of substitution was established by the parties to a repurchase transaction, such right will continue and be recognized by FICC after novation.

- Rule 6B, Section 4 deletes the provision which states that an uncomparared trade will cease to be guaranteed by FICC because this concept is now covered in Rule 5, Section 8.
- Rule 6C, Section 10 deletes the provision which states that a locked-in trade that becomes uncomparared will cease to be guaranteed by FICC because this concept is now covered in Rule 5, Section 8.
- Rule 6C, Section 11 deletes the provision which states that a netting eligible auction purchase that becomes uncomparared will cease to be guaranteed by FICC because this concept is now covered in Rule 5, Section 8.
- Rule 6C, Section 12 deletes the provision which states that a GCF Repo Transaction¹³ that becomes uncomparared will cease to be guaranteed by FICC because this concept is now covered in Rule 5, Section 8.

¹³ Pursuant to the GSD Rules, the term "GCF Repo Transaction" means a Repo Transaction involving generic CUSIP numbers the data on which are submitted to FICC on a locked-

- Rule 11, Section 6 is revised to reflect that (1) novation occurs at comparison; and (2) at netting, the previously novated deliver, receive and related payment obligations between the netting members and FICC will be terminated and replaced by net deliver, receive and related payment obligations as listed in the report made available by FICC to the netting members.
- Rule 11B is revised to correct typographical errors.
- Rule 14, Section 3 is revised to reflect that (1) novation occurs at comparison; and (2) at netting, the previously novated deliver, receive and related payment obligations between the netting members and FICC created by Forward Trades will be terminated and replaced by net deliver, receive and related payment obligations as listed in the report made available by FICC to the netting members.
- Rule 20, Section 5 is revised to reflect that with respect to GCF Repo® transactions, novation will occur at comparison in accordance with Rule 5, Section 8.
- Rule 21A is revised to incorporate the concept of novation.
- Rule 22B included a sentence providing that upon FICC's default, trades that had compared would be deemed novated. Because the GSD Rules are being revised to reflect that novation occurs at comparison, this sentence is no longer necessary. As a result, it is being deleted in connection with this proposal.

With respect to the MBSD Rules, the proposed changes are as follows:

- For clean-up and clarification purposes, the term "Novation" is revised to reflect that delivery, receive and related payment obligations between MBSD clearing members will be

in-trade basis pursuant to the provisions of Rule 6C, for netting and settlement by FICC pursuant to the provisions of Rule 20. GSD Rule 1, Definitions.

terminated and replaced with identical obligations to and from FICC in accordance with the MBSD Rules.

- The term “SBO Contra-Side Member” is revised to correct a typographical error.
- The term “SBO Net-Out Position” is revised to clarify that the term is used in connection with offsetting purchase and sale SBO-Destined Trades that were originally between different clearing members (but, once novated at comparison, are between such members and FICC).
- The term “SBO Net-Out Unit” is being deleted because this term is not used in the MBSD Rules.
- The term “SBO Netted Position” is revised to clarify that the term is used in connection with offsetting purchase and sale SBO-Destined Trades that were originally between the same clearing members (but, once novated at comparison, are between such members and FICC).
- The term “SBON Trade” is revised to correct a typographical error.
- The term “SBOO Trade” is revised to correct a typographical error.
- Rule 5, Section 1 is revised to correct a typographical error.
- Rule 5, Section 2 is revised to reflect that (1) transactions that are not novated pursuant to this proposal (pursuant to new Section 13 of Rule 5 discussed below) and not netted and novated through the Pool Netting system will be settled directly between the Members; and (2) transactions novated pursuant to new Section 13 of Rule 5 and not thereafter netted through the Pool Netting system pursuant to Rule 8 will settle between Members on behalf of FICC.
- Rule 5, Section 12 is revised to correct a typographical error.
- Rule 5 includes a new Section 13 entitled “Novation” which states the following: (1) FICC will guarantee and novate SBO-Destined Trades that meet the requirement of the MBSD Rules and have been entered into in good faith; (2) FICC will not novate SBO-Destined Trades

that are partially compared; (3) to the extent a partially compared SBO-Destined Trade becomes fully compared, FICC will novate such trade; (4) if a trade becomes uncomparred or cancelled, the guaranty and novation of such transaction shall be reversed; (5) at the time that an SBO-Destined Trade is novated to FICC, such trade shall cease to be bound by any bilateral agreement between the parties to the trade with respect to the deliver, receive and related payment obligations, however, if the trade becomes uncomparred or is cancelled, such trade shall be governed by the bilateral agreement that governs such trade prior to the novation.

- Rule 6, Sections 1(a), (b) and (c) are revised to take into account the fact that SBO-Destined Trades are novated upon comparison and are, therefore, legally between MBSD Clearing Members and FICC after comparison.
- Rule 8, Section 6 is revised to take into account the fact that SBO-Destined Trades are novated upon comparison and are, therefore, legally between MBSD Clearing Members and FICC after comparison.
- Rule 8 includes a new Section 7 which is entitled “Obligations to Submit SBOO and SBON Trades to Pool Netting”. This Section reflects a current requirement and current practice that clearing members are required to submit all SBOO trades and SBON trades (i.e., SBO-Destined Trades after such trades have gone through TBA Netting) for inclusion in the Pool Netting system.
- Rule 10, Section 2 is revised to clarify that clearing members are required to submit a notification of settlement for SBO Trades that are novated at comparison and processed through the TBA Netting system but that are not thereafter submitted to the Pool Netting system.

- Rule 11, Section 1 is revised to take into account the fact that SBO Trades are novated upon comparison and are, therefore, legally between MBSD Clearing Members and FICC after comparison.
- Rule 15 is revised to clarify the current process with respect to transactions submitted to and compared by FICC, whereby in the event a member's original counterparty goes insolvent, such member cannot unilaterally modify its obligations with respect to transactions originally entered with such counterparty.
- Rule 16 is revised to clarify the current process with respect to transactions submitted to and compared by FICC, whereby in the event a member's original counterparty goes insolvent, such member cannot unilaterally modify its obligations with respect to transactions originally entered with such counterparty.
- Rule 17, Section 2 is revised to clarify the current process, whereby when FICC ceases to act for a clearing member, such member's Trade-for-Trade Transactions¹⁴ may be disposed of based upon their generic terms such as agency, product, coupon rate and maturity. The other changes are typographical corrections.
- Rule 17A is revised to clarify that in the event of FICC's default, novation is deemed to have occurred with respect to all transactions at the time such transactions are compared, whether or not such transactions are SBO-Destined Trades that would otherwise have been novated at comparison. The other changes to this provision are grammatical corrections.

2. Statutory Basis

The proposed rule changes are consistent with the requirements of Section 17A(b)(3)(F) of the Securities Exchange Act of 1934, as amended (the "Act"), and the rules and regulations

¹⁴ Including "stip" trades and any other TBA transactions not intended for TBA Netting.

thereunder, because by moving novation for trades that enter GSD's Netting system and MBSD's TBA Netting system, they clarify FICC's responsibilities to its members and remove potential uncertainty that previously existed due to a mismatch between the time of guaranty and the time of novation. Such clarity facilitates the prompt and accurate clearance and settlement of securities transactions and assures the safeguarding of securities and funds which are in the custody or control of FICC or for which it is responsible.

As noted above, FICC guarantees (and is therefore responsible for) the settlement of trades upon comparison. Nonetheless, currently FICC does not become the members' legal counterparty with respect to compared trades until the relevant netting output is issued to such members (usually the day before settlement). FICC understands that as members (or their advisors) analyze member netting rights with respect to transactions cleared through FICC for purposes of regulatory capital requirements, it is beneficial for members that FICC become the legal counterparty at the point its guarantee attaches.

B. Clearing Agency's Statement on Burden on Competition.

FICC does not believe that the proposed rule change will have any impact, or impose any burden, on competition that is not necessary or appropriate. The proposed changes will apply to eligible transactions that are submitted to GSD's Netting system and MBSD's TBA Netting system.

C. Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others.

Written comments relating to the proposed rule changes have not yet been solicited or received. FICC will notify the Commission of any written comments received by FICC.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>), or
- Send an e-mail to rule-comment@sec.gov. Please include File Number SR-FICC-2014-11 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-FICC-2014-11. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments

on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of FICC and on its website at <http://www.dtcc.com/~media/Files/Downloads/legal/rule-filings/2014/ficc/SR-FICC-2014-11.pdf>. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FICC-2014-11 and should be submitted on or before [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Kevin M. O'Neill,
Deputy Secretary.

8011-01p

¹⁵ 17 CFR 200.30-3(a)(12).

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